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No. 04-472

Supreme Court, U.S.
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IN THE

Supreme Court of the United States

H&R BLOCK, INC.; H&R BLOCK GROUP INC.; H&R BLOCK SERVICES, INC.; H&R BLOCK TAX SERVICES, INC.; H&R BLOCK EASTERN TAX SERVICES, INC.; H&R BLOCK EASTERN TAX COMPANY, LLC; H&R BLOCK EASTERN ENTERPRISES, INC.; H&R BLOCK EASTERN SUPPORT SERVICES, LLC,
Petitioners,

v.

ERIN M. MCNULTY and BRIAN J. ERZAR, on behalf of themselves and all others similarly situated,
Respondents.

On Petition for a Writ of Certiorari to the Superior Court of Pennsylvania

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REPLY BRIEF

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REPLY BRIEF OF PETITIONERS

Unable to mount a plausible defense of the primary ruling of the Pennsylvania Superior Court – *i.e.*, that court's decision that this case falls outside the scope of the relevant arbitration clause, despite language in the clause expressly saying that the arbitrator should make that judgment – respondents in their brief in opposition defend an entirely different ruling that never occurred. But that effort to deflect attention fails. Respondents are demonstrably incorrect in suggesting that the court rejected arbitration on the ground that petitioners were not parties to the contract containing the arbitration agreement. To the contrary, the court acknowledged that petitioners could invoke the arbitration clause in an appropriate case as third-party beneficiaries, but held that this case fell outside the scope of the arbitration clause – precisely the issue that by agreement was supposed to be decided *in arbitration*.

Having opted for an attempted diversion rather than a defense of the actual ruling below, respondents also fail to rebut petitioners' argument that there is a strong need for this Court to address the first issue presented here. While the Court has made clear that parties may, by agreement, assign to the arbitrator the question whether a given dispute is within the scope of an arbitration agreement, it has not said whether a court may still decide that question when it thinks the answer is sufficiently clear. This case remains a perfect illustration of the abuses that are likely if such a loophole is left open.

As for petitioners' second question presented – whether the court below also erred in addressing unconscionability when the agreement provided that the enforceability of the arbitration clause was itself arbitrable – respondents' only answer is to cite a case, *Green Tree Financial Corp.-Alabama v. Randolph*, 531 U.S. 79 (2000), that is completely

inapposite. The Court in *Green Tree* never addressed whether the validity or enforceability of the arbitration clause should have been arbitrated under the terms of the agreement at issue there. That is because such an argument was never made. The issue was not among the questions presented in this Court and apparently was never raised at any point in the litigation. Thus, here again, respondents offer no real answer to petitioners' argument that if parties may agree to arbitrate the *scope* of an arbitration agreement, they should also be able to arbitrate challenges to its validity and enforceability.

Finally, respondents effectively confirm, rather than rebut, petitioners' argument that the Superior Court's ruling on unconscionability amounts to a determination that it is always unconscionable to agree to arbitrate small claims that a rational plaintiff would never litigate or arbitrate on an individual basis. Whether such a rule is consistent with the FAA is a matter of great controversy among the lower courts and needs to be addressed by this Court.

1. There is no plausible basis for respondents' claim that the Superior Court's ruling refusing to send this case to arbitration turned on the fact that petitioners were not parties to the contract containing the arbitration clause. That clause, contained in a contract made between the consumer and Household Bank, expressly provides that suits brought against "H&R Block, Inc." or its subsidiaries or affiliates are covered by mandatory arbitration provisions. Pet. App. A-32, A-35. A great many courts already have recognized that this obligation can be enforced by petitioners or other Block affiliates as third-party beneficiaries of the contract.[1] And the Superior Court of Pennsylvania did not disagree. It merely ruled instead that there was no need to send this case

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[1] *See, e.g., Carbajal v. H&R Block Tax Servs., Inc.*, 372 F.3d 903 (7th Cir. 2004); *Zawikowski v. Beneficial Nat'l Bank*, No. 98-C-2178, 1999 WL 35304 (N.D. Ill. Jan. 11, 1999).

to arbitration because the particular dispute at issue involving petitioners' electronic filing fee is not within the scope of the "relationships" covered by the arbitration clause. *See* Pet. App. A-10 ("The 'relationship' between Block, the customer and Household [Bank] does not extend to Block, on its own, charging a customer a fee for putting an electronic postage stamp on a tax return."); *see also* Pet. App. A-6 (describing trial court holding as being that the arbitration "provision applied only to the loan transaction itself and not to any other service Block may have provided").

It is thus spurious for respondents to say that the Superior Court, in affirming the decision not to order arbitration, relied on the fact that petitioners were not signatories of the contract containing the arbitration agreement. *See, e.g.*, Br. in Opp. at 12 ("Here, the Superior Court confirmed, based on a careful study of the factual record, that the Household RAL Agreement did not exist between Block and Respondents. Thus, under [various cases cited by respondents but not the court below], an arbitrator lacks authority to resolve any issue pertinent to this lawsuit."). The reality is quite different. In fact, the court expressly noted that it made "a certain amount of sense" to include petitioners in the arbitration agreement because they might be the codefendants in suits challenging the terms of RALs. Pet. App. A-5 ("The arbitration clause has, at least partially, the purpose of guaranteeing all claims regarding the loan be heard together."). It later noted that petitioners could be viewed as "third-party beneficiar[ies]" of the arbitration clause. Pet. App. A-10.

Nor can respondents' argument about petitioners not being signatories of the contract stand as a valid alternative basis for the ruling below. A court adopting that alternative theory would violate the FAA, at least in a jurisdiction like Pennsylvania in which intended third-party beneficiaries

expressly named in a contract are generally authorized to sue to enforce their rights. *See Scarpitti v. Weborg*, 609 A.2d 147, 149 (Pa. 1992); *Melley v. Pioneer Bank, N.A.*, 834 A.2d 1191, 1202 (Pa. Super. Ct. 2003). Section 2 of the FAA, 9 U.S.C. § 2, provides that arbitration agreements may be avoided only on grounds that would apply equally to all other contractual agreements. Thus, as a matter of federal law, Pennsylvania could not adopt a special rule refusing to enforce agreements to arbitrate when they are being asserted by intended third-party beneficiaries.

Moreover, the cases cited by respondents for the proposition that arbitration cannot be compelled when one of the litigants is a non-party to the contract are utterly inapposite. For example, *EEOC v. Waffle House, Inc.*, 534 U.S. 279 (2002), involved a situation where an employee had agreed to arbitrate disputes with an employer, the EEOC then brought suit against the employer, and the employer claimed that the employee's agreement to arbitrate bound the EEOC. The issue thus was whether one party's agreement to arbitrate could bind a third party who did not agree. Because the EEOC had not agreed to arbitrate, the Court held it was not bound to do so. *Id.* at 294. That situation does not remotely resemble the circumstances presented here, where the issue is whether a third party can demand arbitration when sued by a consumer who *expressly agreed* to arbitrate claims brought against the third party. Similarly, *John Wiley & Sons, Inc. v. Livingston*, 376 U.S. 543 (1964), involved the very different question whether an agreement to arbitrate survived a corporate merger (the Court said it did).

Thus, the first question presented is, in fact, raised by the ruling below, and respondents have not suggested a valid rationale for upholding the ruling below on other grounds. Nor is there anything in the brief in opposition rebutting petitioners' argument that there would be great value in

clarifying the rule that parties may agree to arbitrate disputes about whether a particular legal claim falls within the scope of an arbitration clause. Although the Court has repeatedly endorsed agreements of that kind, *see* Pet. 11, and there is no dispute that such an agreement existed here, the Pennsylvania court essentially said that it retained the power to make the judgment that a claim challenging petitioners' electronic filing fees falls outside the very broad scope of the arbitration clause that petitioners invoked. This Court should grant review to make clear that courts may not disregard agreements to arbitrate the scope of an arbitration clause because a rule allowing such a departure in "clear" cases would lead directly to the kind of judicial supplanting of the arbitrator's role that occurred here – in a case where it was *far* from obvious that the dispute fell outside the scope of the arbitration clause.

2. As for the Superior Court's alternative ruling that the arbitration clause, if applicable, was unconscionable, here again the court below had to defy the express language of the arbitration clause in order to address that issue itself. The arbitration clause expressly stated that disputes over the validity and enforceability of the clause were subject to mandatory arbitration. But the court did not bother even to explain why it was not following that explicit direction in the contract.

Respondents seek to defend the Court's action on the ground that this Court did the same thing in *Green Tree*. But as noted above, the defendant in *Green Tree* did not raise any argument that the arbitrator should have been the first to address the question whether the arbitration clause violated public policy. If the defendant had done so, this Court might well have agreed, based on the language of the arbitration clause in that case. But the issue simply was not presented, so *Green Tree* is irrelevant. And none of the other cases

cited by respondents even involved a contract attempting to send disputes over validity or enforceability to arbitration.

3. Finally, respondents offer only a meager defense of the merits of the Superior Court's unconscionability ruling. While emphasizing the purportedly fact-specific nature of that ruling, they do not explain how the Superior Court might have arrived at a different result in any other case involving an individual claim valued at only a few dollars. The essence of the court's ruling was that if the *possible* arbitration fees exceed the amount of money the plaintiff might win individually, the arbitration agreement is unenforceable. That means at a minimum that small claims like those at issue here – valued at less than $30 – can never be subject to mandatory individual arbitration unless it is clear in advance there will be no fees assessed on the plaintiff. And it likely means as well that such small claims are exempt from mandatory arbitration if any other costs – whether it be for photocopying, transportation or just the litigant's time – make it uneconomical to arbitrate an individual claim. The result would be a regime in which very substantial claims must be arbitrated while the smallest claims still can escape arbitration and be cobbled together into class actions, regardless of the terms of applicable arbitration agreements.

As discussed in the petition, Pet. 21-23, there is considerable confusion in the lower courts about whether the FAA permits a state court to allow some litigants to avoid arbitration agreements on the theory that a given small claim can only practically be litigated in court on a class basis. The Court should take this opportunity to address whether a potential arbitration fee exceeding the size of the claim can justify refusing to enforce an arbitration agreement.

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted,

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